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This is in response to a technical coordination report submitted by Revenue Agent Hal Jackson concerning the interaction between section 267(a)(2) and the constructive receipt doctrine.

Section 267 disallows deductions for expenses between certain related parties as defined in section 267(b) who do not use the same method of accounting. Prior to the Tax Reform Act of 1984 (TRA 1984), an accrual basis payor would be denied a deduction for an accrued expense if the expense was payable to a cash basis related party payee and the expense was not paid and not includible in the gross income of the payee within the payor's taxable year or within 2 1/2 months after the close of the payor's taxable year.

The constructive receipt doctrine provides that although income is not actually reduced to a taxpayer's possession it is nevertheless constructively received by him in the taxable year during which it is made available so that he may draw upon it at any time. Income, however, is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Section 1.451-2 of the Income Tax Regulations.

Section 267(a)(2) as amended by TRA 1984 reads in relevant part as follows:

If . . . by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person . . . then any deduction . . . shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made . . .

The TRA 1984 amendments to section 267 provide that instead of allowing a deduction for an expense paid within the related party payor's tax year or 2 1/2 months after the payor's tax year, no

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deduction will be allowed for a related party accrued expense until such time as the related party payee includes such amount in income. The issue presented in the technical coordination report is whether in amending section 267 Congress intended to disallow the potential applicability of the constructive receipt doctrine.

Prior to the TRA 1984, section 267 required that related party expenses be paid or constructively received within the payor's taxable year or within 2 1/2 months of the close of the payor's taxable year. If not paid within the payor's taxable year or 2 1/2 months of the close of the payor's tax year, the expenses would not be deductible no matter when paid. The TRA 1984 amendments to section 267 provide that an accrual basis payor will be able to deduct expenses at the time that a cash basis payee includes such amounts in income, whether or not within the 14 1/2 month period specified in section 267 prior to the TRA 1984 amendments.

Both before and after the TRA 1984 amendments, section 267 denied an otherwise allowable deduction only when the amount of the expense was not includible in the gross income of the payee "unless paid." The "unless paid" language appeared in section 267(a)(2)(B) before the TRA 1984. The amendments to section 267 in the TRA 1984 moved the "unless paid" language to section 267(a)(2)(A). "Unless paid" is not a new restriction added to section 267 by the TRA 1984. Although somewhat rephrased, the meaning of the "unless paid" requirement is the same both before the TRA 1984 amendments and after the TRA 1984 amendments. The "unless paid" language describes the the accounting method, cash, of the payee.

We have also carefully reviewed the legislative history of the TRA 1984. The legislative history of the 1984 amendments to section 267 does not suggest that Congress intended to restrict the applicability of the constructive receipt doctrine in related party transactions. The pertinent part of the House and Senate Committee Reports provides:

Thus, the accrual-basis taxpayer will be allowed to deduct business expenses or interest owed to a related cash-basis taxpayer when payment is made (whether or not paid within 2 1/2 months after the close of the taxable year); in other words, the deduction by the payor will be allowed no earlier than when the corresponding income is recognized by the payee. H. Rep. 98-432, 98th Cong., 2d Sess. 1579 (1984); S. Rep. 98-169, 98th Cong., 2d Sess. 495 (1984).

The legislative history clearly ties the payor's deduction to the time when the amount is included in the payee's gross income. There is nothing in the legislative history, however, which suggests that amounts not actually paid by the payor, but

nevertheless included in the payee's gross income by reason of the constructive receipt doctrine cannot be deducted by the payor. This view of the interaction of the constructive receipt doctrine and section 267 is reflected in the section 267 regulations promulgated prior to the TRA 1984 (Section 1.267(a)-1(b)(iii)) and is the position adopted by the Service in a 1986 private letter ruling.

In PLR 8630059, a corporation using the accrual method of accounting authorized a bonus to be paid to an officer who used the cash method of accounting. The corporation's fiscal year ended [REDACTED] and the bonus was to be paid on or before 75 days after the close of the fiscal year. The officer was a calendar year taxpayer, and he and his wife were the corporation's sole shareholders. PLR 8630059 held the bonus was constructively received by the officer on [REDACTED] and that section 267 did not bar deduction of the bonus amount for the corporation's taxable year ending [REDACTED].

The goal of section 267 is to prevent the allowance of a deduction without a corresponding inclusion in income. S. Rep. 98-169, 98th Cong., 2d Sess. 494 (1984). In situations where an amount is constructively received by the payee, however, there is no mismatch of deduction and income. Accordingly, it is consistent with the objectives of section 267 to allow a payor to deduct expenses that have been constructively received by a related party payee.

For the reasons stated above, we do not believe that a revenue ruling or an amendment to section 1.267(a) of the Income Tax Regulations is necessary to clarify the interaction of section 267 and the constructive receipt doctrine.